

**CALIFORNIA PUBLIC EMPLOYEES' RETIREMENT SYSTEM
STATEMENT OF INVESTMENT POLICY**

**FOR
ALTERNATIVE INVESTMENT MANAGEMENT (AIM) PROGRAM**

September 15, 2008

This policy is effective immediately upon adoption and supersedes all previous Alternative Investment Management (AIM) Program policies.

I. PURPOSE

The CalPERS Total Fund Statement of Investment Policy, adopted by the CalPERS Investment Committee ("Committee"), sets forth CalPERS' overarching investment purposes and objectives with respect to all its investment programs.

This document sets forth the investment policy ("Policy") for the Alternative Investment Management (AIM) Program ("Program"). The design of this Policy ensures that investors, managers, consultants, and other participants selected by the California Public Employees' Retirement System ("CalPERS") take prudent and careful action while managing the Program. Additionally, use of this policy assures sufficient flexibility in managing investment risks and returns associated with this Program.

II. STRATEGIC OBJECTIVE

To maximize risk-adjusted rates of [return](#) while enhancing the CalPERS' position as a premier alternative investment manager is the strategic objective of the Program.

The Program shall be managed to accomplish the following:

- A. Enhance CalPERS' long-term total risk-adjusted return;
- B. Enhance CalPERS' reputation as a premier alternative investment manager and "investor of choice" within the private equity community;
- C. Hedge against long-term liabilities; and
- D. Provide diversification to the CalPERS' overall investment program.

III. RESPONSIBILITIES

- A. CalPERS' Investment Staff ("Staff") is responsible for the following:

1. All aspects of portfolio management including monitoring, analyzing, and evaluating performance relative to the appropriate benchmark.
 2. Reporting to the Committee annually and more often if needed about the performance of the Program. Staff will also report monthly to the Committee regarding investment proposals it has received, the stage they are at in the pipeline, and their ultimate disposition.
 3. Monitoring the implementation of, and compliance with, the Policy. Staff shall report concerns, problems, material changes, and all violations of guidelines and Policies to the Committee at its next meeting, or sooner if deemed necessary. These reports shall include explanations of the violations and appropriate recommendations for corrective action.
 4. Evaluating and selecting [Alternative Investments](#).
 5. In managing this Program, Staff will work cooperatively with the [External Resources](#) it has retained as part of the spring-fed pool. Their primary purpose shall be to serve as an extension of Staff. Staff may also use outside experts, as appropriate, to provide specialized expertise in various disciplines, on a one time basis.
 6. Each investment will be supported by a [prudent person opinion](#) rendered by one of the External Resources in the Spring Fed Pool.
- B. The General Pension Consultant (“Consultant”) is responsible for:
- Monitoring, evaluating, and reporting quarterly, to the Committee, on the performance of the Program relative to the benchmark and Policy.
- C. The [General Partner](#) (“General Partner”) is responsible for:
- All aspects of portfolio management as set forth in each General Partner’s [limited partnership](#) agreement or contract with CalPERS.

IV. PERFORMANCE OBJECTIVES AND BENCHMARKS

A. Long-Term Performance Objective

The long-term expected performance objective of the Program shall be the 10-year rolling average for the total return of the [CalPERS Custom](#)

[Wilshire 2500 Index](#) plus a 300 basis point risk premium. The performance objective is net of fees and expenses.

Use of the CalPERS Custom Wilshire 2500 Index reflects the opportunity cost of investing in Alternative Investments versus publicly traded common stocks. The 10-year rolling average smoothes short-term volatility, is intended to cover at least one complete market cycle, and is consistent with the anticipated average [term](#) of the [partnership investments](#).

B. Short-Term Performance Objective

In order to address differences between the long-term performance objective and young or immature partnership investments, CalPERS shall use a short-term performance objective more appropriate to immature partnership investments as a monitoring device. The Program partnership performance shall be compared to Venture Economics Information Services ("Venture Economics") young fund median returns by [vintage year](#). "Young fund and short-term" shall be defined as the first five years of each individual partnership and the partnership composite portfolio. Exceeding the Venture Economics young fund universe median return, or ranking in the top 50% of the sample universe over the most recent five years is the short-term performance objective.

The short-term performance objective addresses characteristics of young or immature partnership investments that differ from the long-term rolling ten-year CalPERS Custom Wilshire 2500 Index plus 3% performance objective.

These different characteristics include young partnerships with a shorter time frame, reduced liquidity, and a low number of realizations in the early years. Another characteristic unique to young or immature partnership investments includes the "J-curve effect," which results in low or negative returns due to payment of annual [management fees](#) during a period when investments are typically carried at cost and returns have not yet been realized. Partnership investments require time to achieve realizations. Venture capitalists require time to build companies and develop value, and turnaround/corporate restructuring managers also require time to implement strategic, financial, and managerial improvements.

V. INVESTMENT APPROACHES AND PARAMETERS

A. Approach

1. Staff shall manage the Program as a whole with specific criteria appropriate to partnership investments [Direct Investments](#)

(including “[Independently Sourced Investments](#)” and “[Co Investments](#)”) and [New Vehicles](#).

- a. Investment opportunities will be classified as partnership investments when decision-making and management discretion is granted to outside managers.
 - b. Investment opportunities shall be classified as direct investments if CalPERS retains discretion and manages the investment internally or through its external resource(s).
 - c. New Vehicles shall include innovative structures that provide a means to access investment opportunities, exploit CalPERS’ strengths, and achieve the maximum risk-adjusted rates of return. New Vehicles may include partnerships and direct investments or both.
2. “Top down” strategic assessments shall identify portfolio weightings and identify the most attractive segments of the market for investing. Based on these assessments, the Staff shall proactively seek out the most attractive investment opportunities, while maintaining appropriate diversification.
 3. Depending on the form and character of the investment, the Program sets minimum standards for each investment.

B. **Specific Risk Parameters**

There are specific [risks](#) associated with investments that shall be monitored and mitigated by CalPERS. Each segment of the alternative investment market contains uncertainties that are unique to it. CalPERS shall manage the following major categories of uncertainties commensurate with the expected return as an investment proposal is considered:

1. Financial: Alternative investments may employ a greater use of leverage (borrowing), which may lead to a greater volatility in returns.
2. Operating and Business: Certain investments may entail above average operating and business risk.
3. Liquidity: Alternative investments lack liquidity and typically have time horizons of 5-to-10 years. Secondary markets for such investments are very limited. The ability to negotiate specific “exit”

rights (e.g., registration rights, puts and calls) are generally applicable only to Direct Investments.

4. Structural: CalPERS negotiates and structures specific fundamental rights and protections, which include mechanisms for taking remedial action. These basic protections include where appropriate [advisory committee](#) participation and specific termination provisions in partnership [transactions](#); and anti-dilutions, put and call options, voting rights for material events, and other covenants and governance provisions in the case of direct investments.
5. Valuation: Partnerships and co-investments shall be evaluated to determine if the general partner employs an appropriate valuation discipline. For direct investments, the Staff shall review valuations to determine if they are reasonable.

The portfolio shall reduce risk through appropriate diversification by geography, industry, vintage year and investment strategy.

C. Investment Selection

1. The Program shall consider any appropriate investment opportunity with the potential for returns superior to traditional investment opportunities. Investments can be in any industry or geography and may include, but are not limited to:
 - a. [Buyouts](#) or [Corporate Restructuring](#)
 - b. [Expansion Capital](#)
 - c. [Venture Capital](#)
 - d. [Distressed Securities](#)
 - e. [Turnarounds](#)
 - f. [Special Situations](#)
2. Staff shall develop and maintain selection guidelines for Alternative Investments to include the following:
 - a. Minimum requirements with respect to the following:
 - (1) General Partner's relevant investment experience and specific qualifications;

- (2) General Partner's ability to work together;
 - (3) General Partner's ability to dedicate sufficient time and attention to the undertaking;
 - (4) Basic investment vehicle terms;
 - (5) Investment goals and objectives; and
- b. Performance criteria
 - c. [Due Diligence](#) process
 - d. Legal constraints or requirements
 - e. Reporting requirements
 - f. Quality control processes including, but not limited to, investment monitoring and risk control
 - g. Other relevant parameters that may apply

D. Investment Parameters

Alternative Investments may operate under a limited partnership agreement, limited liability company (LLC), or other similar legal structure.

All legal structures shall include specific, written investment guidelines. The guidelines shall outline the fund's investment philosophy and approaches, representative portfolio characteristics, permissible and restricted procedures, and a performance objective commensurate with the investment risk to be incurred.

Implementation of this Program shall comply at all times with the applicable CalPERS investment policies.

VI. CALCULATIONS AND COMPUTATIONS

Investors, managers, consultants, and other participants selected by CalPERS shall make all calculations and computations on a market value which shall be recorded by CalPERS' Custodian.

VII. GLOSSARY OF TERMS

Key words used in the policy are defined in CalPERS' Master Glossary of Terms.

Approved by the Policy Subcommittee:	April 4, 1997
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